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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)

Implementation of the)

Pay Telephone Reclassification)

and Compensation Provisions of the)

Telecommunications Act of 1996)

CC Docket No. 96-128

DA 97-1673 (Remand)

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REPLY COMMENTS OF
CONSUMER FEDERATION OF AMERICA AND CONSUMER ACTION

ON REMAND ISSUES
IN THE PAY TELEPHONE PROCEEDING

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**REPLY COMMENTS OF
CONSUMER FEDERATION OF AMERICA AND CONSUMER ACTION**

I. INTRODUCTION

The Telecommunications Act of 1996 (the Act) required the FCC to establish fair competition for each and every call from pay phones. The FCC issued an Order which, among other things, deregulated the local coin rate and requires carriers to pay a “default” compensation rate of 35 cents for 800 and access code calls, unless otherwise contracted beginning in October, 1997.¹ In October of 1998, the FCC’s rules would permit pay phone operators to charge whatever they wish for these calls.

Petitioners challenged the Commission’s decision and the U.S. Court of Appeals for the D.C. Circuit held that the Commission acted arbitrarily and capriciously. In addition to the legal infirmities raised by the court, this policy is fundamentally anti-consumer, ignores the marketplace realities of pay phone provision and use, and unnecessarily preempts state regulation of local rates.

¹ Implementation of the Pay Telephone Reclassification and Compensation Provisions of the telecommunications Act of 1996, CC Docket No. 96-128.

By deregulating the local coin rate, the FCC effectively condones a hidden rate increase. As the Commission has recognized, the predominant local coin rate today is 25 cents.² In some states, the rate is below 25 cents.³ Upon deregulation of local coin rates in 1998, consumers can expect unfettered increases for local pay phone calls. These pay phone rate increases are not based on cost. Rather, they come simply due to the fact that there is no effective alternative for many pay phone users.

II. THE FCC'S ANALYSIS OF THE PAY PHONE MARKET STRUCTURE IS FUNDAMENTALLY FLAWED

While the market for pay phone provision would appear to be open to competition -- which should lead to lower, not higher, rates -- in reality the market is not competitive. In the decade and a half since competition has become a major thrust of public policy in telecommunications in the U.S., few areas have been more troubling than the competitive provision of pay telephone service. The vast majority of states have found it necessary to regulate entry and pricing in this area. Hundreds of customer complaints have led to repeated proceedings at the federal and state levels to correct abuses that plague the area.

²In the Matter of Implementation of Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Notice of Proposed Rulemaking, CC Docket No. 96-128, June 6, 1996, at para.19, n.59.

³For example, local pay phone rates in California are 20 cents, and as low as 10 cents in Massachusetts, Vermont and New Hampshire. These rates have not been successfully challenged by the companies for not being compensatory.

There are at least three factors that have contributed to the problem in the pay phone market -- the incentive structure for suppliers of pay phone services, lack of consumer sovereignty, and the nature of the transaction itself.

A. THE PROBLEM IN THE INCENTIVE STRUCTURE.

As a general proposition, competition in pay phones does not occur between multiple service providers at an individual location. Rather, competition is between pay phone service providers to get site owners to put their phone, and only their phone, at a given location. As a result, pay phone service providers have an incentive to switch sites to its service by offering royalties or kick backs. The basis of these payments is a location charge paid by callers on each call.

Under this arrangement, the providers get more business. Owners get royalty checks. Both the pay phone provider and site owners profit from the imposition of location charges. The incentive is to increase rates. Even where regulators have adopted rules to govern transactions, the ability to impose price increases creates an incentive structure that rewards avoidance of those rules.

The pay phone provider can exploit this environment by rewarding sales persons with commissions and site owners with prizes. At the same time, the pay phone provider is not likely to exercise oversight and control over marketing personnel. Strong incentives to sell these services and lack of oversight is likely to result in abuse and a failure to comply with Commission rules.

B. THE CONSUMER CHARACTERISTICS OF CONCERN.

The incentive to abuse consumers on the supply-side is not blunted by consumer sovereignty on the demand side. The central issue in formulating sound public policy with respect to placing calls from pay telephones is that use of a pay phone is frequently an urgent expedient. People cannot shop, they need to place the call at that moment, from that location. Whatever phone is there, they must use.

The lack of consumer sovereignty is compounded by the fact that consumers have traditionally not been confronted with a wide range of alternatives at pay phones in the past and they have little opportunity to engage in effective information gathering at the point of purchase.

The idea that someone can simply go find a different phone if they are unhappy with the price being charged is flawed. It ignores the realities of the way pay phones are placed and used. Pay phone providers will try to place their phones throughout a particular neighborhood or facility (i.e. amusement park, airport, train station or mall) so the consumer has only the empty choice of using the excessively priced pay phone or simply not making the call which may not be possible.

There are other groups that will definitely have no choice that will be subject to rate gouging under the Commission's rules. Military personnel, business travelers and others that do not have the luxury to shop around for a reasonable pay phone rate will be in a position to be gouged as well under the Commission's proposal. In some cases, these individuals may be effectively precluded from placing 800 calls at all if the companies which utilize 800 numbers to receive calls choose to block out calls from pay phones to avoid the extra 35 cent charge as the Commission notes is an option.

C. THE CHARACTERISTICS OF THE TRANSACTION THAT ARE PROBLEMATIC.

The fact that a credit card or operator assisted call is a telephone billed transaction creates a further problem. With little information available at the point of purchase, and the bill arriving many days or weeks later, there is a disconnection between the purchase and the bill.

At the point of purchase, there is no tender of a bill to be examined, contemplated or agreed to. Indeed, unless the consumer comes ready with a stop watch, he or she will not know how much was spent for several weeks. The ability to ensure correct billing under such circumstances is virtually nil. Given this lack of concrete evidence of the transaction and the time span between expenditure and billing, the likelihood and ability of consumers to challenge bills is reduced.

Unless the consumer is prepared to tape record the transaction, it is presented and gone in an instant. There is little ability to subject it to post-purchase scrutiny. Moreover, the commodity typically involves a small, infrequent purchase. This reduces the consumer's tendency to seek out other information or follow up after the transactions.

The fact that the transaction takes place electronically compounds problems from the point of view of consumer protection. The offer of services is not subject to public scrutiny. It is difficult for consumer protection agencies to view the commodity, and virtually impossible for them to scrutinize transactions involving real consumers, although they can stage test transactions.

D. THE IMPLICATIONS OF THESE CHARACTERISTICS OF THE TRANSACTION

Given these characteristics, there is little likelihood that the marketplace can weed out abusive practices. Given the nature of the transaction, there is little chance for the exercise of

pre-purchase consumer discretion. Consumers are not likely to be able to learn to avoid pay phones where they are going to be overcharged. Given the nature of the transaction, there is only a small chance that post-purchase complaints and disputes can force pay phone companies to change their behavior. It is difficult for enough consumers to follow up to undermine the profitability of abuse. In sum, there is not likely to be market discipline in the pay phone market.

III. THE FCC'S ECONOMIC ANALYSIS IS FUNDAMENTALLY FLAWED

A. LOCAL RATES

The Commission's decision to permit increases in the local coin rate is based not only on the erroneous assumption about the competitiveness of the market, but also on its conclusion that today's local coin rates are subsidized by other services and are therefore artificially low. All evidence indicates, however, that this conclusion is largely incorrect. Despite the fact that the Commission required the incumbent LECs to remove intrastate subsidies by April 15th, the incumbent LECs have almost uniformly argued at the state level that their local coin rates are not subsidized by other services. Only BellSouth has made any attempt to identify and remove intrastate subsidies. The LECs cannot have it both ways. Either local coin rates are compensatory and not subsidized, in which case there is no justification for increasing the local coin rate, or the LECs must remove these subsidies to prevent double recovery of pay phone costs.

B. THE COST OF OTHER PAY PHONE CALLS

Furthermore, the FCC's rationale for compensation of non-coin calls is even worse. The compensation rate was based on the assumption that all types of pay phone calls incur similar costs. In this respect the FCC is simply incorrect. Coin generated calls are more costly because they require maintenance of the mechanical equipment which collects and returns coins, and the manual collection of deposited coins. Additionally, vandalism to coin operated telephones is also an area which increases costs. At least one estimate, cited by the Court, put the cost of local coin calls three times higher than the cost of coinless calls.⁴

The harm to consumers that will result from the Commission's assumption that a local coin rate increase is required to provide "fair" compensation is compounded by the Commission's equally flawed decision to link the compensation amount for 800 and access code calls to the inflated local coin rate. In the Order, the Commission concluded that 35 cents represented fair compensation for 800 and access code calls because the rate in four states that had deregulated their coin rates had risen to 35 cents. However, the Commission undertook absolutely no analysis of competitive conditions in these states to determine whether the 35 cent coin rate is, as appears likely, the result of continuing market power in an imperfectly competitive market. Moreover, the Commission failed to take into account that the four states in question are all smaller states whose cost structures are likely not representative.

⁴ See AT&T Comment 8-9.

IV. PAY PHONE RATE INCREASES PARTICULARLY DISADVANTAGES

VULNERABLE GROUPS.

The pay phone rate increases that the Commission's initial decision would yield would unfairly affect the most vulnerable groups. There is a significant amount of pay phone usage by low income consumers who can not afford to have phone service in their homes. By increasing the pay phone service rate, the FCC is effectively increasing the rate low income consumers -- those that already have the greatest difficulty obtaining service -- are charged for phone service.

Additionally, many nonprofit organization will be burdened by the increase in costs to them. As noted above, 800 calls and access code calls are cheaper to make than coin activated calls for many reasons. However, the Commission's rules would have had 800 calls incur the same 35 cent charge as coin calls. Since the caller does not pay anything for 800 calls, the owner of the 800 number is the one who will incur the 35 cent charge. While this may simply be an increased cost of doing business (albeit an illegitimate one) for some companies that will be passed on to their customers, that is not the case for non-profit organizations or toll free hotlines.

While one could argue that most people are not going to make catalogue purchases from a pay phone, this is not the case for rape crisis centers, runaway hotlines or poison control centers. In many cases, these organizations and services are already operating on shoestring budgets and an increase as significant as 35 cents per call to their hotlines could force them to cut back on their vital services or close down programs altogether. This is an unconscionable risk based on flimsy analysis that seems to be simply for the benefit of pay phone providers.

V. CONCLUSION: THE COMMISSION SHOULD NOT ASSERT JURISDICTION OVER LOCAL TELEPHONE RATES

The Act certainly does not require the Commission to assert jurisdiction over local pay phone rates. Indeed, state regulators are in the best position to make certain that pay phone providers are fairly compensated for local calls from pay phones in their states. Of course, they have been doing just that as part of the state ratemaking function. Furthermore, to the extent that the debate over Commission jurisdiction to regulate the rates of local pay phone calls arises from the imbalance between § 152(b)⁵ and § 276⁶ of the Act, no clear intent to assert federal jurisdiction over what is plainly a local service can be discerned. In addition, since local pay phone calls are already regulated (or in a few cases) deregulated by the states, the Commission can and should rely on the states to continue to make certain the statutory obligation is met.

In their decision regarding the boundaries of the Commission's regulatory authority over intrastate pay phone rates, the Court cites Louisiana Public Service Commission v. FCC which held that "[t]he crucial question in any preemption analysis is always whether congress intended that federal regulations supersede state law."⁷ In the instant case, Congress has created one act with two explicit, but contradictory statements. Therefore, no clear intent can be discerned.

⁵"[N]othing in [the Act] shall be construed to apply or give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier."

⁶"[The Commission shall] take all actions necessary (including reconsideration) to prescribe regulations that-- establish a per call compensation plan to ensure that all pay phone service providers are fairly compensated for each and every completed intrastate and interstate call using their pay phone..."

⁷ Illinois Public Telecommunications Association v. FCC p. 10.

Louisiana Public Service Commission, held that if the regulation in question was for equipment used by both inter and intrastate services then the Commission could preempt state regulations, however, if the equipment in question could be completely separated from interstate use then the FCC should not be able to preempt the state regulations. Of course, this is the essence of telephone regulation. A clear split of authority over facilities that are used for both interstate and intrastate services. As is the case with other services, the pricing of local pay phone rates are clearly an intrastate issue and should be handled as such. If pay phone provider believe the compensation requirements under the Act are not met, they should take it up with state regulators. The Commission should let state regulations on pay phones stand. At minimum, the Commission should freeze local coin rates at their current levels until it has had the opportunity to study the evolution of competition in the pay phone market.

WHEREFORE, we respectfully request that the Commission modify its orders consistent with these reply comments.

Respectfully submitted,



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